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No. 87-223

In the Supreme Court of the United States

OCTOBER TERM, 1987

SEABOARD SURETY COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioners are sureties for a contractor who defaulted on a federal construction project. When petitioners denied liability under the performance bonds they had executed, the government successfully sued them in federal district court. Petitioners now challenge the jurisdiction of the district court, contending that under the Contract Disputes Act of 1978 (CDA), 41 U.S.C. (& Supp. III) 601 *et seq.*, only the Claims Court had jurisdiction to entertain the government's suit.

1. In the early 1970's, the Department of Agriculture decided to expand its Plum Island Animal Disease Center. The low bid for the construction project was submitted by The Joseph Morton Company (Morton), which was awarded the contract on September 24, 1976. Pet. App. 3a-4a. As required by the Miller Act, 40 U.S.C. (& Supp. III) 270a *et seq.*, Morton obtained a performance bond, which obligated petitioners as sureties to complete the project or pay the government its costs of completion if Morton was terminated for default. Pet. App. 5a, 62a-63a. The government was not a party to the bond. Pet. App. 9a.

Faced from the outset with problems including defective construction, poor maintenance, and undue delays, the government finally terminated Morton for default on March 1, 1979. Pet. App. 4a. The government then asked petitioners to complete the project. They declined, asserting in a letter of May 30, 1980, that Morton's termination for default was improper and that the government had breached the contract. Pet. App. 5a.[1] The government finally engaged another contractor, which was able to complete 60% of the project at an additional cost of approximately $11,400,000. Pet. App. 5a-6a, 17a.

On March 1, 1982, the government filed the present action against petitioners in the United States District Court for the Eastern District of New York.[2]

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[1] Petitioners did offer to complete the project using Morton, an offer which, as the court of appeals put it, "the government understandably rejected." Pet. App. 5a.

[2] There have been several related proceedings. In a criminal action, Morton was convicted of conspiracy to defraud the United States, knowingly submitting false and fraudulent cost statements, and obstructing justice. *United States* v. *Joseph Morton Co.*, No. CR-80-413 (E.D.N.Y. Apr. 24, 1981),

Petitioners thereafter moved to dismiss for lack of jurisdiction, claiming that the CDA vests exclusive jurisdiction over the case in the Claims Court. The district court denied the motion (Pet. Supp. App. 1a-11a). It explained (Pet. Supp. App. 9a) that the CDA governs "disputes between contractors and the government" and noted that while "[a] contractor is a party to a government contract, * * * a surety is not." Reviewing the legislative history of the Act, the court found (*id.* at 10a) "that Congress did not contemplate or intend application of the CDA to include the Miller Act and suits between sureties and the government." The district court accordingly "refuse[d] to construe the CDA so broadly as to include what Congress g[a]ve[] not the slightest suggestion it intended to include" (*ibid.*).

After a two-week trial, the jury returned a verdict against petitioners and awarded the United States $10,631,326.00. Pet. App. 8a. To this sum the district court added $6,755,321.73 in prejudgment interest, calculated from May 30, 1980, the date on which petitioners denied liability under the bond. *Ibid.*

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aff'd, No. 81-1174/1233 (2d Cir. Jan. 11, 1982). Morton filed its own lawsuit in the former Court of Claims, alleging that the government had breached the contract. The Claims Court dismissed Morton's petition and held that Morton's fraudulent conduct justified the government in terminating the contract. *Joseph Morton Co.* v. *United States*, 3 Cl. Ct. 120 (1983). The Court of Appeals for the Federal Circuit affirmed. *Joseph Morton Co.* v. *United States*, 757 F.2d 1273 (Pet. App. 25a-42a). Finally, in January, 1986, the contracting officer on the Plum Island project determined that Morton and petitioners were liable for $14,495,682.00 in damages due to Morton's breach of contract (Pet. App. 66a-70a); their appeal to the Claims Court is pending. *Joseph Morton Co.* v. *United States*, No. 48-86C (Cl. Ct.).

2. The court of appeals affirmed in part, reversed in part, and remanded (Pet. App. 1a-22a). It had "little difficulty" rejecting (*id.* at 9a-10a) petitioners' contention that sureties are "contractors" within the meaning of the CDA and thus that the district court lacked jurisdiction. The court explained (*id.* at 9a) that the CDA applies only to "contract[s] to which the government is a party" and noted that the government was only "a third-party beneficiary, not * * * a party" to the bond between Morton and petitioners. The court also rejected the contention that petitioners should nevertheless be treated as contractors under the CDA because their liability is "derivative from Morton's liability" (*id.* at 10a). "It does not follow * * * that the derivative nature of a surety's liability places it in its principal's shoes for purposes of vesting exclusive jurisdiction in the claims court. * * * Since the liability of a surety is distinct from that of its principal, there is no compelling reason to conclude that a claim by the government against a surety must be tried in the claims court simply because claims against the principal must be heard there under the terms of the CDA." [3]

3. Under 28 U.S.C. 1345, federal district courts have jurisdiction over all cases brought by the United States, "[e]xcept as otherwise provided by Act of

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[3] In addition to its ruling on the jurisdictional question, the court of appeals held that the district court should not have admitted at trial evidence of petitioners' bad faith. The court found that error to be harmless, however. Pet. App. 12a-19a. The court of appeals also held that the district court had abused its discretion in awarding interest from May 30, 1980, and remanded the case for a revised calculation of the prejudgment interest. *Id.* at 19a-22a. The petition does not present these issues.

Congress." [4] Petitioners contend, in essence, that this case falls within the exception to Section 1345, on the ground that the CDA vests exclusive jurisdiction in the Claims Court over suits brought by the United States against Miller Act sureties.

The decision below was correct. The CDA by its terms creates no exception to 28 U.S.C. 1345 for suits by the government—against either contractors or sureties. There is simply no language in the CDA that requires—or even permits—the United States to commence an action in the Claims Court.

Moreover, even if the Act could plausibly be read to require the government to resort to the Claims Court when it sues a "contractor" under an "express or implied contract * * * entered into by an executive agency" (41 U.S.C. 602(a)), the court of appeals was plainly correct in holding that petitioners were not "contractors" and that the government was not suing on such a contract. As the court of appeals observed (Pet. App. 9a), no executive agency of the United States ever "entered into" an "express or implied contract" with petitioners. Petitioners' only agreement was with Morton, and the government was merely a "third-party beneficiary, not * * * a party" to that agreement (*ibid.*). The CDA defines "contractor" to mean "a party to a Government contract other than the Government" (41 U.S.C. 601(4)). Petitioners plainly were not "part[ies] to a Government contract."

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[4] 28 U.S.C. 1345 provides:

> Except as otherwise provided by Act of Congress, the district courts shall have original jurisdiction of all civil actions, suits or proceedings commenced by the United States, or by any agency or officer thereof expressly authorized to sue by Act of Congress.

The legislative history of the CDA confirms the court of appeals' conclusion (Pet. App. 10a) that the Act was not passed with sureties in mind. Congress intended the CDA to establish a fair and comprehensive remedial system "in resolving Government contract claims." S. Rep. 95-1118, 95th Cong., 2d Sess. 1 (1978). Nothing in the committee reports suggests that Congress wished to extend the procedures of the CDA to claims against sureties. Indeed, sureties were not even mentioned in the reports. See S. Rep. 95-1118, *supra*; H.R. Rep. 95-1556, 95th Cong., 2d Sess. (1978). See also *Universal Surety Co.* v. *United States*, 10 Cl. Ct. 794, 800 (1986).

Petitioners contend, however, that they should be treated as contractors under the CDA because their "liability is strictly derivative" of that of their principal (Pet. 13). But apart from the fact that the CDA does not give the Claims Court jurisdiction over government suits against contractors either, petitioners' contention confuses the question of substantive liability with the issue of jurisdiction. Although a surety's ultimate liability depends upon the liability of the contractor, the government's case against a surety stems from the surety's independent failure to perform under the bond. *Royal Indemnity Co.* v. *United States*, 313 U.S. 289, 293 (1941). There is nothing in the CDA that deprives the district courts of jurisdiction over a surety's independent failure to perform. Petitioners suggest (*e.g.*, at Pet. 8-9, 14-17) that it would be more efficient or fairer to require the government to proceed in the Claims Court, but that policy argument, whatever its validity, cannot alter the fact that Congress has conferred jurisdiction over suits by the government on the district courts under Section 1345 and not on the Claims Court under the CDA.

Petitioners suggest (Pet. 11-14) that the decision in this case is in conflict with decisions of this Court and with those of other circuits. In fact, however, the only other case to consider the argument raised by petitioners likewise held that sureties are not contractors under the CDA. *Universal Surety Co.* v. *United States*, 10 Cl. Ct. 794 (1986). In that case, the Claims Court reviewed the language and history of the CDA and concluded (10 Cl. Ct. at 800) that the plaintiff surety was "not a party to the construction contract" with the government and accordingly was "not a 'contractor' under CDA."

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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